

**LOUISIANA STATE UNIVERSITY SCHOOL  
OF MEDICINE IN NEW ORLEANS  
FACULTY GROUP PRACTICE d/b/a  
LSU HEALTHCARE NETWORK  
AND SUBSIDIARIES**

Management's Discussion and Analysis,  
Consolidated Financial Statements as of and  
for the Years Ended June 30, 2012 and 2011,  
and Independent Auditor's Report

## Contents

<b>Independent Auditor's Report</b>	<b>1 - 2</b>
<b>Management's Discussion and Analysis</b>	<b>4 - 12</b>
<b>Basic Consolidated Financial Statements</b>	
Statements of Net Assets	14
Statements of Revenues, Expenses and Changes in Net Assets	15
Statements of Cash Flows	16
Notes to Consolidated Financial Statements	17 - 30
<b>Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i></b>	<b>31 - 32</b>
<b>Schedule of Findings and Questioned Costs</b>	<b>33 - 35</b>
<b>Management's Summary Schedule of Prior Audit Findings</b>	<b>36</b>



LaPorte, APAC  
111 Veterans Blvd. | Suite 600  
Metairie, LA 70005  
504.835.5522 | Fax 504.835.5535  
LaPorte.com

## Independent Auditor's Report

To the Board of Directors of  
Louisiana State University School of Medicine in  
New Orleans Faculty Group Practice

We have audited the accompanying consolidated statements of net assets of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice d/b/a LSU Healthcare Network and Subsidiaries (a Louisiana non-profit corporation) (LSUHN) as of June 30, 2012 and 2011, and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the LSUHN's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of University Medical Group, LLC (a consolidated subsidiary) (UMG), which statements reflect total assets constituting 30% and 38% of consolidated total assets as of June 30, 2012 and 2011, respectively, and total revenues constituting 32% and 36% of consolidated total revenues for the years ended June 30, 2012 and 2011, respectively. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for UMG, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LSUHN as of June 30, 2012 and 2011, and the consolidated changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

NEW ORLEANS HOUSTON BATON ROUGE COVINGTON

An Independently Owned Member, McGladrey Alliance

The McGladrey Alliance is a premier affiliation of independent accounting and consulting firms. The McGladrey Alliance member firms maintain their name, autonomy and independence and are responsible for their own client fee arrangements, delivery of services and maintenance of client relationships.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2012, on our consideration of LSUHN's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 12 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in cursive script that reads "LaForte".

A Professional Accounting Corporation

September 21, 2012



## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

# LSU HEALTHCARE NETWORK AND SUBSIDIARIES

## For the Years Ended June 30, 2012 and 2011

### Management's Discussion and Analysis

---

This section of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice d/b/a LSU Healthcare Network's (LSUHN) annual financial report presents management's discussion and analysis of financial performance during the fiscal year ended June 30, 2012. It should be read in conjunction with the consolidated financial statements in this report.

### OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four components - Management's Discussion and Analysis of Financial Condition and Operating Results (this section), the Independent Auditors' Report, the Consolidated Financial Statements, and the Auditors' Report on Compliance and on Internal Control over Financial Reporting.

The *Consolidated Financial Statements* of LSU Healthcare Network and Subsidiaries report the consolidated financial position of LSUHN and the consolidated results of its operations and its cash flows. The consolidated financial statements are prepared on the accrual basis of accounting. These statements offer short-term and long-term financial information about LSUHN's activities.

The *Consolidated Statements of Net Assets* include all of LSUHN's and its Subsidiaries' assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to LSUHN's creditors (liabilities) for both the current year and the prior year. They also provide the basis for evaluating the capital structure of LSUHN and assessing the liquidity and financial flexibility of LSUHN.

All of the current and prior year's revenues and expenses are accounted for in the *Consolidated Statements of Revenues, Expenses and Changes in Net Assets*. These statements measure the performance of LSUHN's operations over the past two years and can be used to determine whether LSUHN has been able to recover all of its costs through its patient service revenue and other revenue sources.

The primary purpose of the *Consolidated Statements of Cash Flows* is to provide information about LSUHN's cash from operations, investing, and financing activities. The cash flow statement outlines where the cash comes from, what the cash is used for, and the change in the cash balance during the reporting period.

The annual report also includes *Notes to the Consolidated Financial Statements* that are essential to gain a full understanding of the data provided in the consolidated financial statements. The notes to the consolidated financial statements can be found immediately following the basic financial statements in this report.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**For the Years Ended June 30, 2012 and 2011**

**Management's Discussion and Analysis**

**FINANCIAL ANALYSIS OF THE HEALTHCARE NETWORK**

Operating results for fiscal year 2012, before faculty and enhancement payments to the School of Medicine, increased \$13.3 million when compared to fiscal year 2011. Total assets at June 30, 2012, increased \$4.5 million from June 30, 2011, primarily because of increased cash related to amounts reserved by the LSU Healthcare Network board. Unrestricted cash increased \$4.0 million and designated cash decreased \$.4 million, for a net increase in cash of \$3.6 million. Accounts receivable decreased \$.6 million, other receivables increased \$.1 million, prepaid increased \$.1 million and other assets decreased \$.02 million. Current assets exceed current liabilities by approximately \$16.8 million, which is a current ratio of 2.66.

**Condensed Consolidated Statements of Net Assets**  
**(In Thousands)**

	<b>Fiscal Year 2012</b>	<b>Fiscal Year 2011</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Current and Other Assets	<b>\$ 29,724</b>	\$ 26,499	\$ 3,225	12.2 %
Capital Assets	<b>2,889</b>	1,582	1,307	82.6 %
<b>Total Assets</b>	<b>\$ 32,613</b>	\$ 28,081	\$ 4,532	16.1 %
Other Liabilities	<b>\$ 10,133</b>	\$ 11,316	\$ (1,183)	(10.5) %
<b>Total Liabilities</b>	<b>10,133</b>	11,316	(1,183)	(10.5) %
Invested in Capital Assets - Net of Related Debt	<b>2,889</b>	1,582	1,307	82.6 %
Unrestricted	<b>19,591</b>	15,183	4,408	29.0 %
<b>Total Net Assets</b>	<b>22,480</b>	16,765	5,715	34.1 %
<b>Total Liabilities and Net Assets</b>	<b>\$ 32,613</b>	\$ 28,081	\$ 4,532	16.1 %

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**For the Years Ended June 30, 2012 and 2011**

**Management's Discussion and Analysis**

**Summary of Revenues, Expenses and Changes in Net Assets**

The following table presents a summary of the practice's historical revenues and expenses for each of the fiscal years ended June 30, 2012 and 2011:

**Condensed Statements of Revenues, Expenses and Changes in Net Assets**  
**For the Years Ended June 30, 2012 and 2011**  
(In Thousands)

	Fiscal Year 2012	Fiscal Year 2011
<b>Revenues</b>		
Net Patient Service Revenue	\$ 56,787	\$ 43,246
Capitation Revenue	26,441	24,347
Grant Revenue	71	21
<b>Total Revenues</b>	<b>83,299</b>	67,614
<b>Operating Expenses</b>		
Operating and Administrative	50,205	37,927
Medical Claims Expense	22,233	19,413
Depreciation and Amortization	1,024	985
<b>Total Operating Expenses</b>	<b>73,462</b>	58,325
<b>Income from Operations</b>	<b>9,837</b>	9,289
<b>Non-Operating Revenues (Expenses)</b>		
Medical School Enhancement Fund	(5,542)	(4,019)
Interest Income and Other Income and Expenses	1,421	16
<b>Change in Net Assets</b>	<b>5,716</b>	5,286
<b>Net Assets, Beginning of Year</b>	<b>16,765</b>	11,479
<b>Net Assets, End of Year</b>	<b>\$ 22,481</b>	\$ 16,765

During fiscal year 2012, the practice generated 68% of its total revenues from patient care, with the other 32% being derived from capitation revenue from University Medical Group, LLC. There was an increase in the revenues of \$15.7 million from the prior fiscal year.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**For the Years Ended June 30, 2012 and 2011**

**Management's Discussion and Analysis**

---

LSUHN provides care to patients in the Louisiana public hospital system in New Orleans, Baton Rouge and Lafayette, without regard to their ability to pay for those services. During the year ended June 30, 2012, charity charges entered into the billing system and adjusted off, totaled over \$35.4 million compared to \$37.4 million during the year ended June 30, 2011.

Patient service revenue net of contractual adjustments and allowances and bad debt was \$13.5 million higher in fiscal year 2012 than fiscal year 2011. Fiscal year 2012 patient service revenue included over \$7.4 million in Medicaid Upper Payment Limit (UPL) funds compared to \$5.5 million in the prior fiscal year. Net capitation revenue in excess of claims paid decreased \$.7 million compared to fiscal year 2011. Grant revenue increased \$.05 million, as specified in the terms of the grant.

Personnel and leased non faculty expense increased \$.01 million for the year. Physician compensation and enhancement fund expenses increased \$12.9 million. General and administrative expenses increased \$.7 million. Medical supplies expense increased \$.2 million. Depreciation and amortization increased \$.04 million. Dividends received from People's Health Holding, LLC (PHH, LLC) increased \$1.4 million.

The following table represents the relative percentage of gross charges billed for patient services by payor for the years ended June 30, 2012 and 2011:

	<b>Fiscal Year 2012</b>	<b>Fiscal Year 2011</b>
Medicare	<b>17 %</b>	19 %
Medicaid	<b>25</b>	26
Managed Care	<b>27</b>	24
Self-Pay	<b>10</b>	7
Free Care/Indigent	<b>21</b>	24
<b>Total Gross Charges</b>	<b>100 %</b>	100 %

**OPERATING AND FINANCIAL PERFORMANCE**

Operating and financial performance in fiscal year 2012 reflect the steady improvement and stabilization exceeding levels experienced prior to Hurricane Katrina. LSUHN relocated a majority of the clinics from Ochsner Baptist to a new seven floor multi-specialty clinic on St. Charles Avenue near Touro Hospital and expanded services including Radiology and Physical Therapy. LSUHN continues to operate clinic sites in medical office buildings adjacent to Ochsner Baptist, Ochsner Kenner, East Jefferson Hospital, West Jefferson Hospital and in the Behavioral Sciences Center near Touro Infirmary, as well as a private clinic in Baton Rouge. LSUHN's physicians also provide services in hospital-based clinics at Ochsner Kenner, East Jefferson, and the LSU Interim Hospital in New Orleans, Earl K. Long Hospital in Baton Rouge, and University Medical Center in Lafayette.



## **LSU HEALTHCARE NETWORK AND SUBSIDIARIES**

### **For the Years Ended June 30, 2012 and 2011**

#### **Management's Discussion and Analysis**

---

LSUHN is committed to reducing fees and overhead rates being covered by the School of Medicine over a three year period. Because the School of Medicine faced severe budget cuts from the State of Louisiana, LSUHN continued to reduce overhead rates in fiscal year 2012. These reduced fees allowed LSUHN to push cash reserves to the School of Medicine to help cover reductions in State general funds.

The Pediatrics Department of the School of Medicine rejoined LSUHN in July 1, 2011 in order to participate in the Upper Payment Limit (UPL). Pediatrics contributed approximately \$13.2 million in fiscal year 2012. General and administrative expenses increased by \$.7 million in fiscal 2012 primarily due to higher electronic health record expense related to the meaningful use upgrade and higher facility fees primarily related to the new St. Charles Clinic. Medical supplies increased slightly due to the additional supplies needed to open a larger clinic.

The following summarizes the practice's Statements of Revenues, Expenses and Changes in Net Assets between 2012 and 2011:

- Revenue from patient services net of contractual allowances, adjustments and bad debt increased \$13.5 million, or 31.3% from 2011 to 2012 because of Pediatrics and other expanded services.
- Capitation revenue increased \$2.2 million, or 8.6%, because of increased covered lives.
- Non-physician personnel expense increased \$.01 million, or .16%.
- General and administrative expenses increased by \$.7 million, or 5.8%, in 2012. Higher expenses for electronic medical records and facility fees are somewhat offset by lower billing and collection fees in 2012.
- Medical supplies and drugs expense increased slightly by \$.2 million, or 16.8%, during fiscal year 2012 because of the supplies needed to open the St. Charles Clinic.
- Medical claims paid increased \$2.8 million, or 14.5%.
- Payments for leased employees-faculty increased 64.7%, or \$11.4 million, because of increased patient care revenue with slightly higher operating expenses.
- Enhancement Fund payments increased \$1.5 million, or 37.9%, because of increased collections on patient care services.
- Interest and Other Income increased \$1.4 million due to the dividend received from PHH, LLC.

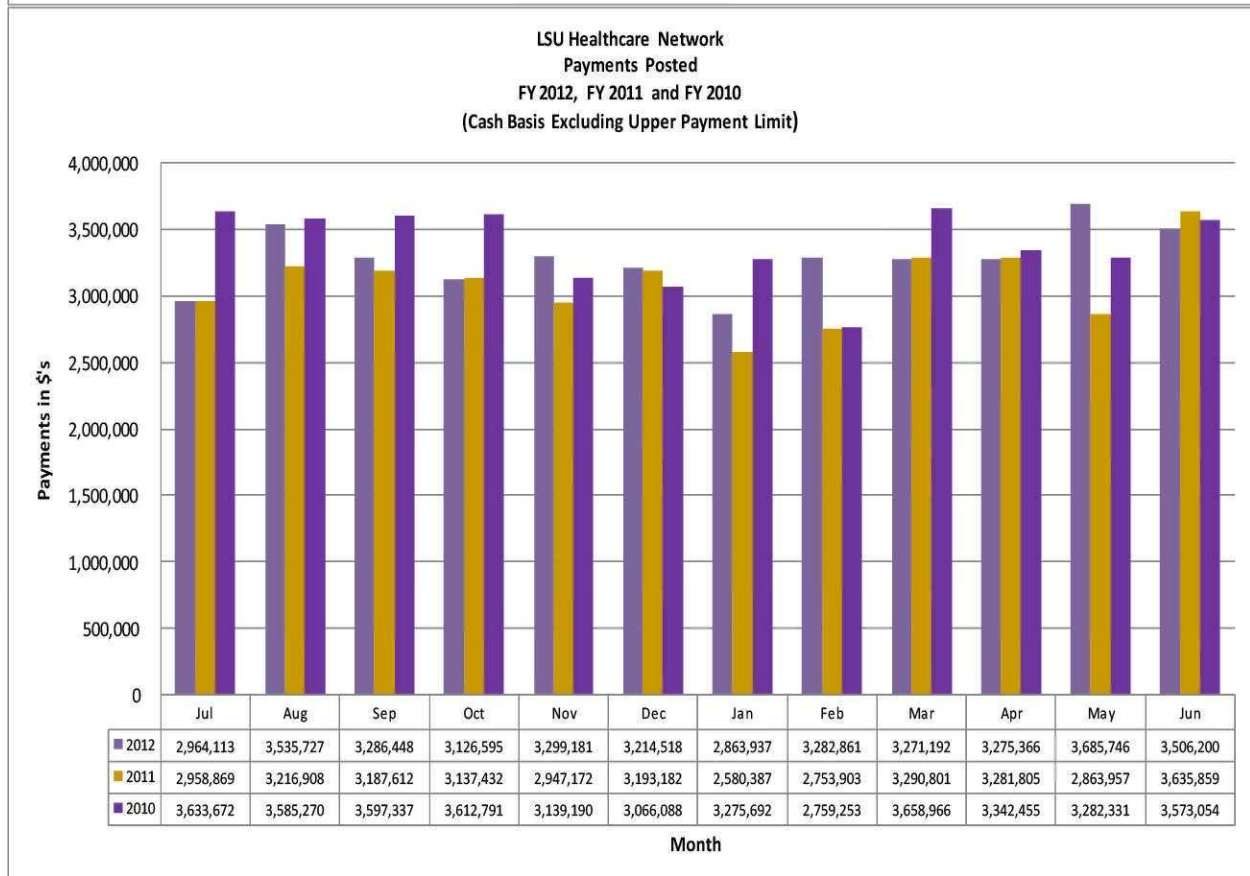
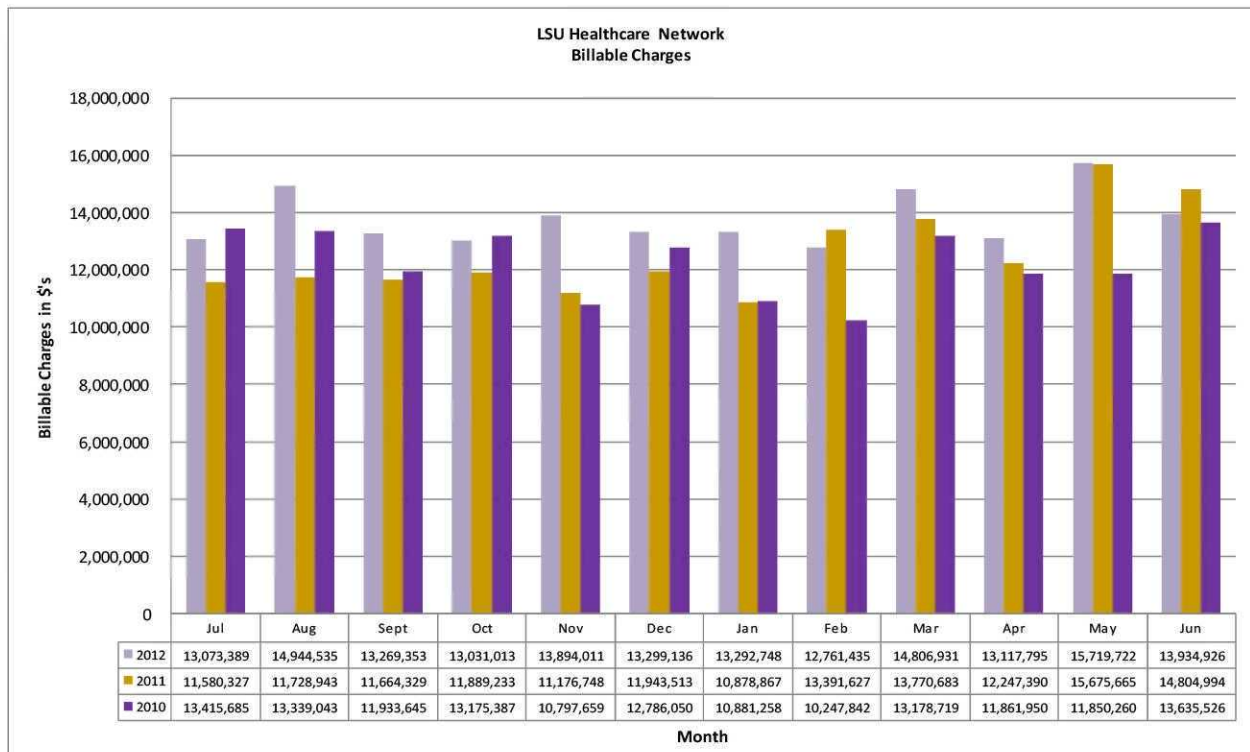
The practice realized an increase in net assets of \$5.7 million in 2012 compared to \$5.3 million in 2011.

The charts on the following pages show the trend in billable charges and payments for patient services for the fiscal years 2012, 2011 and 2010.

# LSU HEALTHCARE NETWORK AND SUBSIDIARIES

## For the Years Ended June 30, 2012 and 2011

### Management's Discussion and Analysis



**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**For the Years Ended June 30, 2012 and 2011**

**Management's Discussion and Analysis**

Ambulatory patient volume in LSUHN private clinics increased over 16% in fiscal year 2012. Charges exceeded prior year in most months of fiscal year 2012 reflecting the increased number of patient encounters. Cash collections increased because of the significantly higher UPL payments received and the inclusion of the Pediatrics Department collections in 2012. Collections excluding the UPL payments increased due to increases in the New Orleans area.

Capital asset purchases of approximately \$2.3 million in fiscal 2012 were primarily related to items needed for the St. Charles Clinic including radiology equipment, computers, phones and furniture and medical equipment for the Endocrine Clinic in Kenner. Relocation of the Baptist and Plastics clinics, and the Administration office resulted in retirements of \$.7 million during FY12.

**Capital Asset Summary**  
**(In Thousands)**

	<b>Fiscal Year 2012</b>	<b>Fiscal Year 2011</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Office Furniture and Telephones	\$ 835	\$ 689	\$ 146	21 %
Computers and Related Equipment	1,406	873	533	61 %
Medical Equipment	1,765	989	776	78 %
Leasehold Improvements	774	637	137	22 %
License Fees	2,618	2,581	37	1 %
Totals at Historical Cost	7,398	5,769	1,629	28 %
Less: Accumulated Depreciation and Amortization	(4,509)	(4,187)	(322)	8 %
<b>Capital Assets - Net</b>	<b>\$ 2,889</b>	<b>\$ 1,582</b>	<b>\$ 1,307</b>	<b>83 %</b>

## **LSU HEALTHCARE NETWORK AND SUBSIDIARIES**

### **For the Years Ended June 30, 2012 and 2011**

#### **Management's Discussion and Analysis**

---

#### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

Patient service revenue is expected to have increased volumes in the private sector with the continued expansion of services and increased network referrals especially at St. Charles Clinic. Capitation revenue is expected to have a moderate increase due to the continued growth of the patient base. Total operating expense for patient services is expected to increase due to the increased services at the St. Charles Clinic and additional expenses for the electronic health record system.

LSUHN entered into a five year master lease with Touro Infirmary for approximately 70,000 square feet located on St. Charles Avenue. The St. Charles Clinic opened in October 2011 and is anticipated to have one (1) five year renewal. LSUHN will use this space to consolidate and integrate some of its clinical services now being provided in multiple sites throughout the New Orleans area, including leased space from Ochsner Medical Center and to establish a LSU medical office complex in the central part of New Orleans.

Under the amended and restated agreement and pursuant to the Uniform Affiliation Agreement, LSUHN, in coordination with the Dean of the School of Medicine and the Dean of the School of Dentistry, will be relocating clinical faculty to provide primary care, dentistry and some specialty services. With continued budget cuts from the State of Louisiana, the expansion in private sector business of the network will provide some much needed relief to supplement the budget.

#### **CONTACTING THE PRACTICE'S FINANCIAL MANAGER**

This financial report is designed to provide our customers and creditors with a general overview of LSUHN's finances. If you have questions about this report or need additional financial information, please contact the Chief Financial Officer, LSU Healthcare Network, 1542 Tulane Ave., Suite 123-HCN, New Orleans, LA 70112.

#### **REPORT OF MANAGEMENT'S RESPONSIBILITY**

The management of LSUHN is responsible for the preparation and integrity of the financial information presented in this report. The basic consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board and the Financial Accounting Standards Board and include amounts based on judgments and estimates made by management. Management also prepares the other information included in the report and is responsible for its accuracy and consistency with the consolidated financial statements.

The consolidated financial statements have been audited by the independent accounting firm of LaPorte who was given unrestricted access to all financial records and related data, including the minutes of all meetings of the Board of Directors. The Board of Directors, through its Finance Committee (the Committee), provides oversight to the financial reporting process. Integral to this process is the Committee's review and discussion with management of the monthly financial statements and the external auditors for the annual consolidated financial statements.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**For the Years Ended June 30, 2012 and 2011**

**Management's Discussion and Analysis**


---

LSUHN maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded and that assets are properly safeguarded, and also to provide reasonable assurance to our management and the Board of Directors regarding the reliability of our consolidated financial statements. The internal control system includes:

- A documented organizational structure and division of responsibility.
- Established policies and procedures that are regularly communicated and that demand high ethical conduct from all employees.

LSUHN's Executive Committee and Finance Committee monitor the operations and internal control system and report findings and recommendations to management and the Board of Directors as appropriate. Corrective actions are taken to address control deficiencies and other opportunities for improvement as they are identified.

Louisiana State University School of Medicine in New Orleans Faculty Group Practice (d/b/a LSU Healthcare Network)



---

Sharon Rives,  
Chief Financial Officer



## **CONSOLIDATED FINANCIAL STATEMENTS**

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Consolidated Statements of Net Assets**  
**June 30, 2012 and 2011**

	2012	2011
<b>Assets</b>		
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 14,826,275	\$ 10,823,610
Designated Cash	327,472	714,157
Patient Accounts Receivable (Net of Contractual Allowances and Doubtful Accounts of \$19,396,061 in 2012 and \$21,475,823 in 2011)	11,307,192	11,900,442
Prepaid Expenses and Other Receivables	506,931	286,874
<b>Total Current Assets</b>	<b>26,967,870</b>	<b>23,725,083</b>
<b>Capital Assets, Net</b>	<b>2,889,435</b>	<b>1,582,366</b>
<b>Other Assets</b>		
Deposits and Investments	2,756,191	2,773,397
<b>Total Other Assets</b>	<b>2,756,191</b>	<b>2,773,397</b>
<b>Total Assets</b>	<b>\$ 32,613,496</b>	<b>\$ 28,080,846</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts Payable and Accrued Liabilities	\$ 854,121	\$ 1,450,553
Medical Claims Payable	1,737,292	1,867,395
Unearned Income	-	189,476
Due to LSU Health Sciences Center	7,541,239	7,808,748
<b>Total Current Liabilities</b>	<b>10,132,652</b>	<b>11,316,172</b>
<b>Net Assets</b>		
Invested in Capital Assets, Net of Related Debt	2,889,435	1,582,366
Unrestricted	19,591,409	15,182,308
<b>Total Net Assets</b>	<b>22,480,844</b>	<b>16,764,674</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 32,613,496</b>	<b>\$ 28,080,846</b>

The accompanying notes are an integral part of these consolidated financial statements.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Consolidated Statements of Revenues, Expenses and**  
**Changes in Net Assets**  
**For the Years Ended June 30, 2012 and 2011**

	2012	2011
<b>Revenues</b>		
Net Patient Service Revenue, Net of Provision for Bad Debts of \$11,139,359 in 2012 and \$8,318,175 in 2011	\$ 56,787,098	\$ 43,246,543
Capitation Revenue	26,441,317	24,346,709
Grant Revenue	70,825	20,904
<b>Total Revenues</b>	<b>83,299,240</b>	<b>67,614,156</b>
<b>Operating Expenses</b>		
Leased Employees - Faculty	29,057,003	17,646,656
Leased Employees - Non-Faculty	601,615	592,358
Personnel - Salaries and Benefits	7,195,980	7,192,535
General and Administrative	11,941,058	11,287,880
Medical Supplies	1,410,518	1,207,534
Medical Claims Expense	22,232,747	19,413,066
Depreciation and Amortization	1,023,514	985,238
<b>Total Operating Expenses</b>	<b>73,462,435</b>	<b>58,325,267</b>
<b>Income from Operations</b>	<b>9,836,805</b>	<b>9,288,889</b>
<b>Other Revenues (Expenses)</b>		
Medical School Enhancement Fund	(5,541,828)	(4,019,332)
Interest Income and Other Income and (Expenses), Net	1,421,193	16,272
<b>Total Other Revenues (Expenses), Net</b>	<b>(4,120,635)</b>	<b>(4,003,060)</b>
<b>Change in Net Assets</b>	<b>5,716,170</b>	<b>5,285,829</b>
<b>Net Assets, Beginning of Year</b>	<b>16,764,674</b>	<b>11,478,845</b>
<b>Net Assets, End of Year</b>	<b>\$ 22,480,844</b>	<b>\$ 16,764,674</b>

The accompanying notes are an integral part of these consolidated financial statements.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
**For the Years Ended June 30, 2012 and 2011**

	2012	2011
<b>Cash Flows from Operating Activities</b>		
Cash Received from Clinic Operations	\$ 56,938,361	\$ 42,607,292
Cash Received from Grant Revenue	70,825	20,904
Cash Received from Capitation Revenue	26,566,743	23,724,860
Cash Payments for Personnel	(7,954,362)	(7,774,972)
Cash Payments for Leased Employees Faculty and Non-Faculty	(29,401,623)	(17,901,951)
Cash Payments for Supplies and General and Administrative	(13,894,907)	(12,929,239)
Cash Payments for Medical Claims	(22,362,850)	(19,563,773)
<b>Net Cash Provided by Operating Activities</b>	<b>9,962,187</b>	<b>8,183,121</b>
<b>Cash Flows from Non-Capital Financing Activities</b>		
Cash Payments for Enhancement Fund	(5,338,710)	(4,032,339)
Cash (Payment) Received for Grant Income	(118,643)	102,193
Cash Received from Deposits	17,205	-
Decrease (Increase) in Designated Cash	386,685	(538,320)
<b>Net Cash Used in Non-Capital Financing Activities</b>	<b>(5,053,463)</b>	<b>(4,468,466)</b>
<b>Cash Flows from Capital and Related Financing Activities</b>		
Payments on Leases Payable	-	(32,286)
Purchase of Capital Assets	(2,362,684)	(682,524)
Interest Payments	-	(940)
<b>Net Cash Used in Capital and Related Financing Activities</b>	<b>(2,362,684)</b>	<b>(715,750)</b>
<b>Cash Flows from Investing Activities</b>		
Interest and Other Income Received	13,744	16,008
Increase in Investment	1,442,881	-
<b>Net Cash Provided by Investing Activities</b>	<b>1,456,625</b>	<b>16,008</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>4,002,665</b>	<b>3,014,913</b>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>10,823,610</b>	<b>7,808,697</b>
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 14,826,275</b>	<b>\$ 10,823,610</b>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Income from Operations	\$ 9,836,805	\$ 9,288,889
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities		
Depreciation and Amortization	1,023,514	985,238
Provision for Bad Debt	11,139,359	8,318,175
Change in Assets and Liabilities		
Increase in Patient Accounts Receivable, Net	(10,546,109)	(9,753,317)
Increase in Prepaid Expenses and Other Receivables	(220,057)	(42,309)
(Decrease) Increase in Accounts Payable and Other Liabilities	(1,003,816)	105,260
Decrease in Due to LSU Health Sciences Center	(267,509)	(718,815)
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 9,962,187</b>	<b>\$ 8,183,121</b>

The accompanying notes are an integral part of these consolidated financial statements.

# LSU HEALTHCARE NETWORK AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

---

### Note 1. Summary of Significant Accounting Policies

#### Reporting Entity

Louisiana State University School of Medicine in New Orleans Faculty Group Practice, d/b/a LSU Healthcare Network and Subsidiaries (LSUHN), a Louisiana non-profit corporation, assists the LSU Health Sciences Center (LSUHSC) in carrying out its medical, educational, and research functions. The Board of Directors consists of seven (7) members who are representatives of the Board of Supervisors of Louisiana State University and Agricultural and Mechanical College (LSU), the LSUHSC and the LSU School of Medicine in New Orleans as well as eight (8) Public or Community members who are not employees of LSU and are nominated by either the Nominating Committee or any member of the Board of Directors. Upon dissolution of LSUHN, any remaining assets would be distributed to the Board of Supervisors of LSU or its successor for distribution to LSUHSC or to the Louisiana State University Medical Center Foundation. LSUHN provides health care to the general public including, but not limited to, the delivery of physician medical services and other health care services to individuals. LSUHN receives compensation for these services from the Medicare and Medicaid programs, certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and directly from patients.

LSUHN's activities include services provided in both the public hospitals and the private clinics serviced by LSUHSC. LSUHN and LSUHSC (through the Board of Supervisors of LSU) have entered into Cooperative Endeavor and Operating Agreements that permit the two entities to work together on a mutually beneficial basis. The agreements delineate the obligations and responsibilities of both LSUHN and LSUHSC. Both parties have the right to terminate the Cooperative Endeavor Agreement with or without cause upon 60 days written notice. The agreements expired October 31, 2005, and have continued to be renewed on a quarterly basis since its expiration.

In August 2011, LSUHN and LSUHSC (through the Board of Supervisors of LSU) entered into a restated and amended agreement and pursuant to the Uniform Affiliation Agreement. The agreement establishes support of the Board of Supervisors of LSU A&M and LSUHSC-NO in the attainment of its mission and goals, particularly as they relate to the LSUHSC-NO Schools of Medicine, Allied Health Professions, Dentistry, Nursing and Public Health (collectively, the Health Professional Schools) in their clinical practices.

#### Basis of Accounting

The financial statements of LSUHN have been prepared using the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting/or Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the LSUHN has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) except those that conflict with a GASB pronouncement, including those issued after November 30, 1989.



## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 1. Summary of Significant Accounting Policies (Continued)

##### **Consolidation**

The consolidated financial statements include the accounts of LSUHN and its wholly owned subsidiaries; University Medical Group, LLC, LSUHN Surgery Center, LLC, University Technology Group, LLC, LSUHN Vascular Lab, LLC and LSUHN Billing, LLC. The significant intercompany transactions and balances have been eliminated.

The activity of the subsidiaries of LSUHN is as follows:

*University Medical Group, LLC* - LSUHN is the sole member of University Medical Group, LLC (UMG). UMG indirectly contracts with health maintenance organizations and other third-party payors under capitated arrangements to provide physician health care services to members who select UMG primary care physicians. UMG operates primarily in the New Orleans, Louisiana metropolitan area.

The purpose of UMG is to pursue risk contracts in which providers accept capitated payments for health care services. UMG has three primary goals: (1) to gain and protect market share for its providers, and (2) to generate and distribute surpluses in the event that capitation payments received exceed the cost of health care services provided, and (3) to maintain an ownership in PH Holdings, LLC.

*LSUHN Surgery Center, LLC* - LSUHN is the sole member of LSUHN Surgery Center, LLC (LSUHN SC). LSUHN SC was formed to manage the day-to-day operations, including the billing and collection efforts, of the surgery center located at 2020 Gravier Street in New Orleans, Louisiana. LSUHN SC has not resumed activity since August 29, 2005, when Hurricane Katrina struck. There are no plans for LSUHN SC to resume activity.

*University Technology Group, LLC* - LSUHN is the only member of University Technology Group, LLC (UTG). UTG was formed to participate in technology ventures that will assist LSUHN in the delivery of health care services or any other activities that will enhance LSUHSC's ability to carry out its medical, educational or research missions. UTG has been inactive for several years and there are no plans to resume activity.

*LSUHN Billing, LLC* - LSUHN is the sole member of LSUHN Billing, LLC (LSUHN Billing). LSUHN Billing was formed in December 2007 for use by the billing company that handles Baton Rouge and Lafayette billing.

*LSUHN Vascular Lab, LLC* - LSUHN is the sole member of LSUHN Vascular Lab, LLC (LSUHN Vascular). LSUHN Vascular was formed in October 2009 for the purpose of owning and operating an independent vascular laboratory to provide vascular ultrasound testing to patients from the community. There was no activity in fiscal years 2012 or 2011.

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 1. Summary of Significant Accounting Policies (Continued)

##### **Use of Estimates (Continued)**

Estimates also affect the reported amounts of revenues and expenses during the reporting period. Estimates which are significant for LSUHN include contractual and bad debt allowances and the liability for medical claims payable. Accordingly, actual results could differ from those estimates.

##### **Cash and Cash Equivalents**

LSUHN considers all highly liquid investments in money market funds and investments available for current use with an initial maturity of three months or less to be cash equivalents. Amounts are recorded at fair value.

##### **Designated Cash**

Designated cash represents UMG's allocable portion of the distributable cash in the catastrophic reserve pool.

##### **Capital Assets**

Capital assets are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line basis over the estimated useful lives of the assets, which range from 3-5 years. Assets held under capital lease obligations are recorded at the present value of the minimum lease payments and are included in equipment. Amortization of leased assets is included in depreciation and amortization expense.

##### **Medical Claims Payable**

The unpaid medical claims liability represents management's best estimate of the ultimate net cost of all reported and unreported claims incurred, but not paid, during the reporting period. The estimate is based on actuarial projections of the historical development of claims incurred but not reported and case-basis estimates of claims reported prior to the end of the reporting period.

The estimate of the unpaid medical claims liability was based on the best data available to UMG; however, because of the limited number of members covered by UMG, the estimates are subject to a significant degree of inherent variability. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Although management believes the estimate of the unpaid medical claims liability is reasonable under the circumstances, it is possible that UMG's actual incurred claims expense will not conform to the assumptions inherent in the determination of the liability; accordingly, the ultimate settlement of the claims may vary significantly from the estimate included in the accompanying consolidated financial statements.

During fiscal years ended June 30, 2012 and 2011, UMG recognized unfavorable development of \$196,000 and favorable \$72,000, respectively, due to changes in estimates of the unpaid medical claims liability at June 30, 2011 and 2010. These changes in estimates resulted from the actual frequency and severity of claims differing from original estimates.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### **Note 1. Summary of Significant Accounting Policies (Continued)**

##### **Operating versus Non-Operating Revenue and Expenses**

LSUHN distinguishes operating revenue and expenses from non-operating items. Operating revenue and expenses generally result from providing services in connection with LSUHN's principal ongoing operations. The principal operating revenue of LSUHN is for patient services. Operating expenses include patient services expense, general and administrative expenses, supply and other expenses, and depreciation and amortization expenses. All revenue and expenses not meeting this definition are reported as non-operating revenue and expenses.

##### **Patient Service Revenue Net of Contractual Adjustments and Allowances**

LSUHN has agreements with third parties that provide for payments at amounts different from its established rates. Net patient service revenue is reported in the financial statements at the estimated net amounts realizable from patients, third-party payors, and others for services rendered. Major third-party payor arrangements include the Medicaid and Medicare programs.

LSUHN has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and Coordinated Care Networks (CCNs). The basis for payments to LSUHN under these agreements includes prospectively determined rates per office visit and discounts from established charges.

To ensure accurate payments to providers, the Tax Relief and Healthcare Act of 2006 mandated the Centers for Medicare and Medicaid Services (CMS) to implement Recovery Audit Contractor (RAC) and Medicaid Integrity Contractor (MIC) programs on a permanent and nationwide basis no later than 2010. The program uses RACs and MICs to search for potentially improper Medicare and Medicaid payments that may have been made to health care providers that were not detected through existing CMS program integrity efforts, on payments that have occurred at least one year but not longer than three years. Once a RAC or MIC identifies a claim it believes to be improper, it makes a deduction from the provider's Medicare or Medicaid reimbursement in an amount estimated to equal the overpayment.

LSUHN will deduct from revenue amounts assessed under the RAC and MIC audits at the time a notice is received until such time that estimates of net amounts due can be reasonably estimated. RAC and MIC assessments are anticipated; however, the outcome of such assessments is unknown and cannot be reasonably estimated.

In late July 2011, Louisiana Medicaid agency selected five private entities to manage care for most of the states' Medicaid enrollees in a new program beginning January 2012. These entities contracting with the Louisiana Department of Health and Hospitals will serve as Coordinate Care Networks (CCNs). The CCNs will coordinate care for adults with disabilities not enrolled in Medicare, children younger than 19, their parents, and pregnant women, allowing them to choose their own CCN.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 1. Summary of Significant Accounting Policies (Continued)

##### **Patient Service Revenue Net of Contractual Adjustments and Allowances (Continued)**

LSUHN contracted with the five entities and negotiated favorable fee schedules. The effect of this change is somewhat uncertain. While better rates were negotiated with the CCNs, the Upper Payment Limit (UPL) will not be available for this portion of the Medicaid business.

##### **Charity Care**

LSUHN provides care to patients in the Louisiana public hospital system without regard to their ability to pay for those services. LSUHN does not pursue collection of charges generated from providing services to patients that are determined to qualify for charity care and, as a result, these charges are not reported as revenue. However, in certain areas, the billing process requires that some free care charges be entered into the system before they are adjusted out of revenues.

During the years ended June 30, 2012 and 2011, charity charges entered into the billing system and adjusted off were approximately \$35,400,000 and \$37,370,000, respectively.

As noted above, for those charity care charges entered into the billing system and adjusted off, accounts classified as charity care are written off immediately.

##### **Capitation Revenue**

UMG, the wholly owned subsidiary of LSUHN, has entered into an agreement with New Orleans Regional Physician Hospital Organization, Inc. (NORPHO) whereby UMG has authorized NORPHO to contract with purchasers of healthcare services for the delivery of health care services to covered members. UMG pays a management fee to NORPHO for management services provided under a management services contract.

UMG receives capitation payments as compensation for a commitment to provide health care services to covered members. Capitation payments are recognized as revenue during the period in which UMG is obligated to provide health care services to these members.

##### **Grant Revenue**

LSUHN has received a grant from Louisiana Public Health Institute (LPHI) to provide discounted or free psychiatric services. As of June 30, 2012 and 2011, \$70,825 and \$20,904, respectively, was included as revenue on the consolidated statement of revenues and expenses and changes in net assets. The grant funds received, but not expended, including interest was \$-0- and \$189,476, as of June 30, 2012 and 2011, respectively, and is reflected on the consolidated statements of net assets as unearned income.

LSUHN is a subrecipient of a federal grant awarded to LSUHSC to provide a nurse practitioners clinic to serve the under-privileged population. The clinic opened in January 2011 in the Village Du Jardin development and is part of LSUHN. Due to delays in construction and the lengthy screening process for residents, there has been limited patient activity since the clinic opened. As of June 30, 2012, LSUHN had expended \$86,453, which will be reimbursed from the grant. This amount is also recorded on the statement of net assets as other receivables.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 1. Summary of Significant Accounting Policies (Continued)

##### Medical Claims Expense

LSUHN contracts with various physicians, physician groups, and other ancillary providers under the terms of primary/specialty care physician agreements or other ancillary agreements for the purpose of providing health care services on behalf of LSUHN. Based on the nature of the agreements, medical expense is recognized either during the period in which LSUHN is obligated to provide medical services for members, or during the period in which medical services are provided to members.

LSUHN participates in a catastrophic reserve pool with the other independent physician associations (IPAs) in the Network to provide shared-risk insurance coverage on physician charges in excess of certain limits. LSUHN has stop-loss insurance coverage with an unrelated insurer for charges that exceed the limits covered by the catastrophic reserve pool. Amounts recoverable from the catastrophic reserve pool and the unaffiliated insurer are classified as accounts receivable on the consolidated statements of net assets. In addition, LSUHN classifies pharmacy rebate receivables as accounts receivable on the consolidated statements of net assets.

##### Income Taxes

LSUHN is a non-profit corporation organized under the laws of the State of Louisiana. It is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986, and qualifies as a support organization, as defined in Section 501(a) of the Code.

LSUHN's wholly owned subsidiary, University Medical Group, LLC, holds a minority ownership investment in PH Holdings, LLC, which is a holding company formed in November 2011 that elected to be an S corporation effective January 1, 2012. Effective for the year ended June 30, 2013, net income derived from this investment will be subject to tax from unrelated business activities. LSUHN has filed a request for a private letter ruling from the Internal Revenue Service that its minority interest in this S corporation, through its wholly owned subsidiary, will not affect its tax-exempt status. No response to this request has been received as of the date of this report. LSUHN will commence making quarterly estimated tax deposits on this unrelated business activity during the fiscal year ending June 30, 2013.

LSUHN follows the provisions of the *Accounting for Uncertainty in Income Taxes* Topic of the FASB ASC, which clarifies the accounting and recognition for income tax positions taken, or expected to be taken, in LSUHN's income tax returns. As a result of this adoption, the LSUHN believes there was no impact to the financial statements.

All tax returns have been appropriately filed by LSUHN. LSUHN recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense. LSUHN files income tax returns with federal and state jurisdictions. LSUHN's open audit periods are 2009 - 2012. Management evaluated the LSUHN's tax positions and concluded that LSUHN had taken no uncertain tax positions that require adjustments to the financial statements to comply with the provisions of this guidance.



## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 1. Summary of Significant Accounting Policies (Continued)

##### Net Assets

LSUHN prepares its financial statements in accordance with GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. It requires the classification of net assets into three components - invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

*Invested in Capital Assets - Net of Related Debt* - This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and amortization and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

*Restricted* - This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

*Unrestricted* - This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

##### Reclassifications

Certain reclassifications have been made in the June 30, 2011 consolidated statements to conform to the June 30, 2012 presentation. These reclassifications have no effect on the previously reported change in net assets.

#### Note 2. Related Party Transactions

LSUHSC provides certain clinical and administrative services to LSUHN. Amounts paid for services provided under this arrangement were \$29,401,623 and \$17,901,951, during the years ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, \$6,064,527 and \$6,409,148, respectively, was owed to LSUHSC for physician and non-physician services, including amounts accrued relating to accounts receivable.

In accordance with the Cooperative Endeavor and Operating Agreements with LSUHSC, LSUHN will provide management services, nursing services, technical support services, clerical services, billing and collection services and other support personnel as necessary. Amounts paid for general support services were \$726,179 and \$1,273,586, during the years ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, \$36,200 and \$162,206, respectively, was due to LSUHSC for general support services.

Also under this agreement, LSUHSC requires LSUHN to pay at least ten percent (10%) of its annual gross cash receipts to LSUHSC, through the Medical School Enhancement Fund (MSEF) to support the clinical, academic and research missions of LSUHSC.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### **Note 2. Related Party Transactions (Continued)**

Cash payments totaling \$5,338,710 and \$4,032,339, were made to the MSEF during the fiscal years ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, \$1,440,511 and \$1,237,394, respectively, was due to LSUHSC for MSEF payments, including amounts accrued relating to accounts receivable.

Several IPAs, including UMG, and NORPHO operate as the Network. The Network operates under a master operating agreement with People's Health, Inc. (PHI), a health maintenance organization (HMO), wholly owned by NORPHO. The Network provides covered medical services under certain Medicare Advantage HMO, POS, PPO and prescription drug plans to covered members located in southeast Louisiana.

NORPHO is a physician hospital organization that contracts with PHI under a capitation arrangement to provide physician and hospital health care services to plan members. NORPHO provides all administrative services necessary for the operation of the Network, including, but not limited to, financial services, medical management, claims processing, member services and provider relations.

Prior to December 9, 2011, the IPAs operating in the Network, collectively own 100% of the issued and outstanding shares of Class A common stock of NORPHO. No other class of stock was issued and outstanding as of December 9, 2011. UMG held less than 20% investment in NORPHO and accounted for the investment under the cost method. On December 9, 2011, UMG redeemed their shares in NORPHO and invested in PH Holdings, LLC, a Louisiana limited liability company established on November 15, 2011. As a result of the transaction, UMG holds less than a 20% investment interest in PH Holdings, LLC at June 30, 2012.

As discussed in Note 1, UMG, the wholly owned subsidiary of LSUHN, operates under a master operating agreement with NORPHO. The agreement expires on December 31, 2012. Management fees were \$3,570,237 and \$2,984,444, for the years ended June 30, 2012 and 2011, respectively.

UMG has an out-of-network claims reimbursement agreement with NORPHO that requires NORPHO to reimburse UMG monthly for out-of-network claim payments that exceeded 5% of the period's capitation revenue. Under the terms of this agreement, UMG recovered \$4,928 and \$88,229, for the years ended June 30, 2012 and 2011, respectively. The agreement terminated as of December 31, 2011.

#### **Note 3. Major Payor**

Currently, all contracts with third-party payors are executed through NORPHO. UMG, the wholly owned subsidiary of LSUHN, earned 100% of capitation revenue from PHI. PHI and NORPHO contract with Centers for Medicare and Medicaid Services (CMS) under a Medicare Advantage contract.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### **Note 3. Major Payor (Continued)**

Under the terms of the Medicare Advantage contract, PHI has agreed to provide medical services to Medicare enrollees in return for capitated payments under the products Choices 65, Choices Select, Choices Plus, and Secure Health. The contract automatically renews for successive periods of one year unless written notice of intention not to renew is given. The contract has been renewed through December 31, 2012. Approximately 100% of PHI's revenue is earned under contracts for these products. A significant modification to, or termination of, this arrangement could have a material effect on UMG's results of operations and financial condition.

UMG, through the Network, offers Medicare Part D prescription drug insurance coverage under a contract with CMS. The CMS Premium, the Member Premium, and the Low-Income Premium Subsidy represent payments for UMG's insurance risk coverage under the Medicare Part D program and, therefore, are recorded as gross capitation revenues in operations. Gross capitation revenues are recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. Pharmacy benefit costs and administrative costs under the contract are expensed as incurred and included in medical claims expense.

#### **Note 4. Gross Capitation Revenue**

The plans provide prescription drug benefits to members under the Medicare Part D contract. The capitation revenue is subject to risk corridor adjustment, which permits the plans and CMS to share the risk associated with the ultimate costs of the Part D benefit. The adjustment may be positive or negative based on the application of risk corridors that compare a plan's actual prescription drug costs to its targeted costs, as reflected in the Medicare Part D bid. The plans also receive subsidies from CMS for all or a portion of the deductible, co-insurance, and co-payment amounts for low-income beneficiaries, subsidies for coverage gap costs, and reinsurance subsidies for catastrophic costs. Amounts received for these subsidies are not reflected as premium revenue, but rather are accounted for as deposits. A settlement with CMS of the prospective subsidies based on actual prescription drug costs paid by the plans is made after the plans' year-end.

UMG, the wholly owned subsidiary of LSUHN, estimates and recognizes an adjustment to gross capitation revenue related to the risk corridor adjustment and an adjustment to drug costs for the low-income cost subsidy based upon prescription drug claims experience to date. UMG recorded an asset of \$61,232, at June 30, 2012, for the 2012 and 2011 calendar year plans, for its share of the Network plan settlements with CMS. In November 2011, the Network received notification from CMS related to the reconciliation and final settlement of the calendar year 2010 Network Part D Plan. UMG's share of the final settlement liability resulted in a decrease to premium revenue of \$71,991, during the year ended June 30, 2012.

The difference between the recorded estimate and the final determination of the amount to be received or paid will be recorded when such determinations are made and the final settlement amount could vary significantly from the amount recorded at June 30, 2012.

# LSU HEALTHCARE NETWORK AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### Note 4. Gross Capitation Revenue (Continued)

UMG, the wholly owned subsidiary of LSUHN, periodically receives retroactive revenue adjustments from CMS resulting from changes in risk adjustment scores for prior periods. At June 30, 2012, UMG recorded an asset of \$115,185 for these adjustments related to the period January 1, 2012 to June 30, 2012.

At June 30, 2012, UMG accrued \$186,534 for estimated risk score adjustments to calendar year 2011 revenue. The amount was received by UMG in August 2012. At June 30, 2011, UMG accrued \$410,569 for estimated risk score adjustments to 2010 revenue. The amount was received by UMG in August 2011. These amounts were included in accounts receivable on the consolidated statements of net assets at June 30, 2012 and 2011.

### Note 5. Capital Assets

Capital asset activity for fiscal years ended June 30, 2012 and 2011, were as follows:

	Balance 2011	Additions	Deletions	Balance 2012
Office Furniture and Fixtures	\$ 688,536	\$ 146,698	\$ -	\$ 835,234
Computers and Related Equipment	873,408	532,221	-	1,405,629
Medical Equipment	989,039	1,512,676	(736,487)	1,765,228
Leasehold Improvements	637,260	136,679	-	773,939
License Fees	2,580,984	37,350	-	2,618,334
<b>Total at Historical Cost</b>	<b>5,769,227</b>	<b>2,365,624</b>	<b>(736,487)</b>	<b>7,398,364</b>
<b>Less: Accumulated Depreciation and Amortization</b>	<b>(4,186,861)</b>	<b>(1,023,514)</b>	<b>701,446</b>	<b>(4,508,929)</b>
<b>Capital Assets, Net</b>	<b>\$ 1,582,366</b>	<b>\$ 1,342,110</b>	<b>\$ (35,041)</b>	<b>\$ 2,889,435</b>
	Balance 2010	Additions	Deletions	Balance 2011
Office Furniture and Fixtures	\$ 644,548	\$ 43,988	\$ -	\$ 688,536
Computers and Related Equipment	516,991	356,417	-	873,408
Medical Equipment	779,889	219,650	(10,500)	989,039
Leasehold Improvements	427,147	210,113	-	637,260
License Fees	2,580,984	-	-	2,580,984
<b>Total at Historical Cost</b>	<b>4,949,559</b>	<b>830,168</b>	<b>(10,500)</b>	<b>5,769,227</b>
<b>Less: Accumulated Depreciation and Amortization</b>	<b>(3,212,123)</b>	<b>(985,238)</b>	<b>10,500</b>	<b>(4,186,861)</b>
<b>Capital Assets, Net</b>	<b>\$ 1,737,436</b>	<b>\$ (155,070)</b>	<b>\$ -</b>	<b>\$ 1,582,366</b>

Depreciation and amortization expense amounted to \$1,023,514 and \$985,238, for the fiscal years ended June 30, 2012 and 2011 respectively.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 6. Other Assets

##### Investments

At June 30, 2011, UMG held less than a 20% investment in NORPHO, which amounted to \$2,531,213. On December 9, 2011, UMG redeemed their shares in NORPHO and invested in PH Holdings, LLC, a limited liability corporation established on November 15, 2011. As a result of these transactions, NORPHO became a wholly owned subsidiary of PH Holdings, LLC. At June 30, 2012, UMG holds less than a 20% investment interest in PH Holdings, LLC and accounts for the investment under the cost method. In 2012, UMG received distributions from PH Holdings, LLC of \$1,442,881, which are recorded in other income on the consolidated statements of revenues, expenses and changes in net assets, however, because UMG now holds more than a 10% investment interest in PH Holdings, LLC, it is subject to those provisions of the Louisiana Insurance Code relating to insurer holding companies, which include disclosure of certain transactions, prior approval of certain transactions, and filing and reporting obligations. UMG does not believe that compliance with these laws will have a material adverse affect on the operations of UMG.

#### Note 7. Lease Commitments

##### Operating Leases

LSUHN leases office space and equipment under operating leases that expire at various dates through 2017. Certain of the lease agreements provide for escalations based on cost of operations.

Minimum annual lease payments as of June 30, 2012, are as follows:

Year Ending June 30,	Amount
2013	\$ 1,980,870
2014	1,530,496
2015	1,221,813
2016	1,107,062
2017	<u>322,283</u>
<b>Total</b>	<b><u>\$ 6,162,524</u></b>

Total rent expense for all of the above leases for the years ended June 30, 2012 and 2011, was \$2,080,588 and \$1,783,816, respectively.

## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

#### Note 8. 401(k) Plan

In December 1997, LSUHN established a 401(k) plan for the benefit of its employees. The plan permits employees to contribute up to 15% of their compensation to the plan, subject to certain limitations. At its discretion, LSUHN may make contributions to the 401(k) plan for the benefit of participating employees. For the years ended June 30, 2012 and 2011, 401(k) plan expenses were \$223,025 and \$258,539, respectively.

Beginning January 2012, LSUHN transitioned to a safe-harbor plan, whereby the employee will be able to contribute up to 16% of their compensation into the plan, subject to certain limitations. The participating employees will receive a dollar for dollar matching on their contributions from LSUHN, up to a maximum of 6%.

#### Note 9. Concentrations of Credit Risk

LSUHN provides services in New Orleans, Baton Rouge, and Lafayette. LSUHN grants credit to its patients, some of whom are insured under third-party payor agreements. LSUHN routinely obtains assignment of, or is otherwise entitled to receive patients' benefits from Medicare, Medicaid and other third-party payors.

The mix of receivables from its patients and third-party payors at June 30, 2012 and 2011, was as follows:

	2012	2011
Medicare	23 %	17 %
Medicaid	35	32
Commercial	24	28
Self-Pay	18	23
<b>Total</b>	<b>100 %</b>	<b>100 %</b>

LSUHN routinely invests available operating funds in highly liquid U.S. Government and agency obligations and money market mutual funds that generally invest in highly liquid U.S. government and agency obligations. Investments in money market funds are not insured or guaranteed by the U.S. Government; however, management believes the credit risk related to these investments is minimal.

#### Note 10. Change in Third-Party Billing Companies

LSUHN terminated its billing contract with PST Services, Inc. (PST) on April 30, 2011. Transition services were provided by PST for 90 days. Beginning May 1, 2011, LSUHN contracted with Acadiana Computer Services, Inc. (ACS) to provide billing services formerly provided by PST. On August 1, 2011, account balances from PST were transferred to ACS for collection services.



## LSU HEALTHCARE NETWORK AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

---

#### Note 11. Insurance Coverage

##### **Malpractice Insurance**

The physicians leased to LSUHN by LSUHSC are provided professional liability coverage by LSUHSC in accordance with the provisions of LA. R.S. 40:1299.39 et seq. for the services provided under the Cooperative Endeavor and Operating Agreements. These provisions provide the physician with coverage on malpractice claims up to \$500,000 per occurrence, which is the limit on medical malpractice claims under current state law.

#### Note 12. Government Regulations

The healthcare industry is subject to numerous laws and regulations of Federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government oversight has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The Office of the Inspector General of the Department of Health and Human Services has undertaken a project to audit Medicare billings of certain academic medical institutions. The government has stated that it believes that a significant amount of Medicare claims filed by teaching physicians are not properly documented as required by current interpretations of Medicare standards. If a provider is found to be in violation of these documentation standards, the government may require repayment of any overcharges and may impose a penalty of treble damages plus up to \$10,000 per false claim. Management believes that LSUHN is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations, and with the Medicare documentation standards. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Legislation and regulation at all levels of government have affected and are likely to continue to affect the operations of LSUHN. Federal healthcare reform legislation proposals debated in Congress in recent years have included proposals for the imposition of price controls and/or healthcare spending budgets or targets, significant reductions in Medicare and Medicaid program reimbursement to healthcare providers and the promotion of a restructured delivery and payment system focusing on competition among providers based on price and quality, managed care, and steep discounting or capitated payment arrangements with many, if not all, of LSUHN's principal payors. It is not possible at this time to determine the impact on LSUHN of government plans to reduce Medicare and Medicaid spending, government implementation of national and state healthcare reform or market-initiated delivery system and/or payment methodology changes. However, such changes could have an adverse impact on operating results and cash flows of LSUHN in future years.



## **LSU HEALTHCARE NETWORK AND SUBSIDIARIES**

### **Notes to Consolidated Financial Statements**

---

#### **Note 13. Commitments and Contingencies**

In October 2006, LSUHN was named as a defendant in two lawsuits claiming wrongful death and damages resulting from the action of a physician leased by LSUHN from LSUHSC. The incidents occurred in a New Orleans hospital during the aftermath of Hurricane Katrina. LSUHN intends to vigorously defend itself and its representatives against these actions. At this time management is unable to determine with any certainty the settlement prospects or probability of success of either of these suits.

LSUHN has certain other pending and threatened litigation and claims incurred in the ordinary course of business; however, management believes that the probable resolution of such contingencies will not exceed LSUHN's insurance coverage, and will not materially affect the financial position of LSUHN or the results of its operations.

Upon expiration of the billing services contract with PST and ACS on April 30, 2011, LSUHN contracted with ACS as the sole third-party billing company beginning May 1, 2011. The contract rate for net cash collections for ACS is 13% for public business, 5.5% for private business and 7% for New Orleans Anesthesia business.

In October 2011, LSUHN opened a multi-specialty clinic in uptown New Orleans with expanded services including imaging. LSUHN signed a management services agreement with Diagnostic Imaging Services (DIS) to manage and operate the imaging center. LSUHN reimburses DIS for expenses incurred and an additional 5% fee as set in the agreement. The agreement extends through December 31, 2015.

#### **Note 14. Subsequent Events**

Management has evaluated subsequent events through September 21, 2012, the date that the consolidated financial statements were available to be issued and determined that no events occurred that require disclosure. No subsequent events occurring after this date have been evaluated for inclusion in these consolidated financial statements.



LaPorte, APAC  
111 Veterans Blvd. | Suite 600  
Metairie, LA 70005  
504.835.5522 | Fax 504.835.5535  
LaPorte.com

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors of  
Louisiana State University School of Medicine in  
New Orleans Faculty Group Practice

We have audited the financial statements of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice, d/b/a LSU Healthcare Network and Subsidiaries (a Louisiana non-profit corporation) (LSUHN) as of and for the year ended June 30, 2012, and have issued our report thereon dated September 21, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

Management of LSUHN is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered LSUHN's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of LSUHN's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of LSUHN's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

NEW ORLEANS HOUSTON BATON ROUGE COVINGTON

An Independently Owned Member, McGladrey Alliance

The McGladrey Alliance is a premier affiliation of independent accounting and consulting firms. The McGladrey Alliance member firms maintain their name, autonomy and independence and are responsible for their own client fee arrangements, delivery of services and maintenance of client relationships.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether LSUHN's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Directors and the Louisiana Legislative Auditor and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Louisiana Legislative Auditor as a public document.

A handwritten signature in cursive script that reads "LaForte".

A Professional Accounting Corporation

September 21, 2012

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Schedule of Findings and Questioned Costs**  
**For the Year Ended June 30, 2012**

---

**Part I - Summary of Auditor's Results**

**Financial Statement Section**

Type of Auditor's Report Issued	Unqualified
---------------------------------	-------------

Internal Control Over Financial Reporting:

Material Weaknesses Identified?	No
---------------------------------	----

Significant Deficiencies Identified not Considered to be Material Weaknesses?	No
--	----

Noncompliance Material to Financial Statements Noted?	No
---	----

Management's Summary Schedule of Prior Audit Findings	See Attached
---	--------------

Memorandum of Other Comments and Recommendations	No
--	----

**Federal Awards Section**

Internal Control Over Major Programs:

Material Weaknesses Identified?	N/A
---------------------------------	-----

Significant Deficiencies Identified not Considered to be Material Weaknesses?	N/A
--	-----

Type of Auditor's Report on Compliance for Major Programs:	N/A
--	-----

Any Audit Findings Disclosed that are Required to be Reported in Accordance with OMB Circular A-133 (Section 510(a))?	N/A
--	-----

**Identification of Major Programs**

Dollar Threshold Used to Determine Type A and Type B Programs:	N/A
--	-----

Auditee Qualified as Low-Risk Auditee?	N/A
--	-----

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Schedule of Findings and Questioned Costs (Continued)**  
**For the Year Ended June 30, 2012**

---

**Part II - Financial Statement Findings Section**

None noted.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Schedule of Findings and Questioned Costs (Continued)**  
**For the Year Ended June 30, 2012**

---

**Part III - Federal Awards Findings and Questioned Costs**

Not applicable.

**LSU HEALTHCARE NETWORK AND SUBSIDIARIES**  
**Management's Summary Schedule of Prior Audit Findings**  
**For the Year Ended June 30, 2012**

---

**2011-1 Credit Card Expenses**

*Condition:* We noted during the audit that the entity did not maintain adequate documentation on all purchases made on the corporate credit card during the year. Certain credit card transactions only had the credit card statement as documentation of the purchase.

*Status:* Resolved.